Journal of Accountancy

Volume 52 | Issue 3 Article 3

9-1931

Criminal Law and Its Relation to Accountancy

Michael S. Forest

Criminal Law and Its Relation to Accountancy

By Michael S. Forest

It is a well settled principle that everyone is presumed to know the law of the land, both common and statute, and that ignorance of the law furnishes no exemption from criminal responsibility. The accountant who is familiar only with that phase of the civil law which deals with commerce should also understand the criminal law, especially those features of it which may relate to commerce, finance and other subjects within the scope of the accountant's activity. This paper is prepared for the purpose of presenting some of the aspects of the criminal law which may have a bearing upon the practice of accountancy.

Thoroughly to understand the possible relationship of criminal law to accountancy, it is necessary to define terms which are relevant.

The great body of law is divided into many parts. Two of the main divisions are the civil and the criminal law. In the present discussion there will be no attempt to deal with procedure but rather with those acts or omissions which constitute crimes. I shall further limit myself to crimes not involving moral turpitude, violence or injury against the person.

The law of many states regarding crimes is statutory, and what constitutes a crime can be ascertained by reference to the statutes of the respective states. In New York the penal law defines a crime as an act or omission forbidden by law and punishable upon conviction. This definition is somewhat in need of elucidation.

In the commission of a crime we are frequently concerned with two parties; to wit, the principal and the accessory. A principal is a person concerned in the commission of a crime, whether he directly commits the act constituting the offense or aids and abets its commission, and whether present or absent. A person, therefore, who directly or indirectly counsels, commands, induces or procures another to commit a crime, is a "principal."

A person who, after the commission of a felony, harbors, conceals or aids the offender, with intent of having him perhaps avoid or escape from arrest, trial, conviction or punishment, or having knowledge or reasonable ground to believe that such offender is liable to arrest, has been arrested, is indicted or convicted or has committed a felony, is an "accessory" to the felony.

The statute of the state of New York does not adequately define the terms misdemeanor and felony. Suffice it to say, however, that a misdemeanor is a crime of less degree than a felony, and a felony is a crime punishable by death or imprisonment in a state's prison.

In the commission of a crime we often are met with the question of intent to commit the crime, or motive, malice and other considerations too numerous to mention. An interesting and yet concise presentation of this phase of the subject is presented to us in the following excerpt:

"To constitute a crime the act must, except in case of certain statutory crimes, be accompanied by a criminal intent or by such negligence or indifference to duty or consequences as is regarded by the law equivalent to a criminal intent. Neglect in the discharge of a duty or indifference to consequences is in many cases equivalent to a criminal intent." (2 Corpus Juris 1.)

The law has even gone a step further in holding that the most laudable motive is no defense where the act committed is a crime; and on the other hand a bad motive does not make an act a crime if it is not so in law.

True enough, the ethical standards in the accounting profession are in a great many respects far above the standards set by the law in relation to our dealings with the public. It is however essential that the accountant be fully apprised of his legal obligations to his client as well as to the state or sovereignty under whose jurisdiction he resides and practises.

The foregoing cursory interpretations of the criminal law are presented to the accountant because of their pertinence to the subject at hand.

The accountant is continually called upon to prepare financial statements, he is asked for his advice and opinion, required to testify before legal tribunals, and because of these manifold duties he must be ever on guard not to be the dupe or pawn of unscrupulous business enterprises. By his unintentional negligence, by his unintentional indifference to duty, the accountant may unknowingly commit a crime for which he may be held responsible either as a principal or an accessory.

It is well to remember that if a person who was injured by the commission of a crime has condoned the offense or made a settlement with the defendant or with some person on his behalf it does not relieve the defendant or bar a prosecution by the state.

The element of personal liability to the accountant for negligence in the performance of his work may be both civil and criminal, and despite the fact that the person injured has recourse to the civil courts, there still attaches the right of the state to prosecute criminally. The law has held in numerous cases that the public and the person injured by a crime each has a distinct although concurrent remedy; for a criminal act is both a private and a public wrong, and these remedies may operate simultaneously. Recovery in a civil action, therefore, does not bar criminal prosecution.

In the course of his work the accountant comes across acts performed by his client which in many instances constitute a crime. Yet, because he is unaware that such acts constitute a crime, he may issue financial statements, with or without the qualified certification, as to the accurateness, etc., of the books audited, and thus becomes either a principal or an accomplice to a crime. To illustrate this point I refer the reader to the case of *People* v. *Grossman*, 241 N. Y. 138. This case dealt with bucket shops. The penal law relating to bucket shops is as follows:

"BUCKET SHOPS. Sect. 390. Any person, . . . whether acting in his, their or its own right, or as the officer, agent, servant, correspondent or representative of another, who shall, make or offer to make, or assist in making . . . any contract respecting the purchase or sale, either upon credit or margin, of any securities . . . and without intending a bona fide purchase or sale of the same . . . but intending a settlement of such contract based upon the difference in such public market quotations or prices at which said securities or commodities are, or are asserted to be, bought or sold; . . . shall be guilty of a felony."

One of the defendants in this case was a bookkeeper whose principal duty was to take charge of the books of the concern whereon were carried fictitious and misleading accounts. The bookkeeper understood perfectly well, for some time before the occurrence of the particular transactions under review in this case, that the business which was carried on and the conduct of it in which she was taking part was of an unlawful character, prohibited by the penal law.

The court in rendering its decision held the bookkeeper guilty as an accomplice.

From the opinion of the chief justice in this case, the inference can be drawn that the accountant who is engaged by a firm that maintains a bucket shop and is fully aware of the criminal purpose

would also be an accomplice and be guilty of a felony. I quote part of his decision—

"possessing entire knowledge of its criminal purposes, a jury could say that each of these witnesses became, some time before the transactions in question, part of the organization whose purpose it was to fleece victims by bucket shop methods. Each one had an appointed place in the organization and in the operation of the machinery by which unsuspecting people were drawn into the trap and defrauded of their money. . . . It is immaterial that somebody else possessed the 'master mind' or that these witnesses, were tools or agents or employees. A master mind is no protection to the tool who yields to it and engages in the commission of what he knows is a crime. The criminal law does not recognize the rules of principal and agent as an exoneration of the latter from liability and the orders of a superior do not erect a protective bulwark between the employee or tool who engages in the commission of a felony and responsibility for the part which he plays no matter how subordinate it may be."

To what extent this doctrine would be carried by the courts is difficult to say. It is my opinion that the accountant, who is familiar with the circumstances, as was the bookkeeper in the foregoing case, would be held as an accomplice. The tone of the judge's opinion goes even further—it implies that an employee of the accountant would possibly be held as an accomplice.

This principle of law can be extended to other criminal cases. Would the accountant who is employed to audit, prepare statements and generally to render acounting service for one who is conducting an illegal business, such as a gambling establishment, be guilty as an accomplice? According to the foregoing decision the answer would probably be in the affirmative and the accountant would be held criminally liable. It is possible, however, that, because the crime had already been completed, the accountant having worked after the commission of the crime, might not be held responsible. On the other hand, if his work spread over a period of time, during which he counseled and advised, in addition to auditing, the law might construe his acts as part of the crime.

The penal law of New York, as well as many other states, scrutinizes the acts of officers, directors, trustees or employees of banking corporations more than it does those of ordinary business. The reason is obvious. The accountant will do well to consider those sections of the penal law. (In N. Y. sections 290 to 305, inclusive.) A brief summary of these sections will give an insight into their content. The subject deals with the sale or hypothecation

of bank notes by officers; bank officers overdrawing their accounts or asking for or receiving commissions or gratuities from persons procuring loans or making overdrafts of their accounts; receiving deposits in insolvent bank; issuing false statements or rumors as to banking institutions; falsefication of books, reports or statements of corporations subject to the banking law, etc.

The adages that the shoemaker should stick to his last, and that anyone who is his own lawyer usually has a fool for a client still carry their appropriate lessons. No physician should advise how to build bridges, nor should an accountant advise on matters that are within the domain of the lawyer. The accountant's knowledge of the law is only to be used to avoid unnecessary litigation and to aid him in the pursuit of his calling. The accountant may express his opinion in general terms when his client is doing an illegal act, but he should advise the client to consult counsel.

Where a client is engaged in an illegal pursuit the duty rests upon the accountant to prepare for filing a tax return setting forth the true profit of the client. The law is that anyone who is engaged in an illegal pursuit must pay a tax on the profits.

The accountant who is called to testify as a witness at a trial and is advised by his client that the subpoena need not be answered, or that it was merely a formality and that he need not appear, should remember that he is committing a crime. Sect. 379 N. Y. penal law states:

"A person who is, or is about to be a witness upon a trial, hearing, or other proceeding, before any court, or any officer authorized to hear evidence or take testimony, who receives, or agrees or offers to receive, a bribe, upon any agreement or understanding that he will absent himself from the trial, hearing, or other proceeding, is guilty of a felony."

See also the case of *People* v. *Maynard*, 151 App. Div. N. Y. 790. The law held that a person who, when about to be subpoenaed as a witness before the grand jury (or any legal tribunal), accepts a bribe to absent himself is guilty of a violation of this section.

In order to prevent legal entanglements it is always advisable to keep all work sheets, statements and other documents of the clients available for use when called upon as a witness. One should always guard against the accusation of having wilfully destroyed any papers.

A person who, knowing that a book, paper, record, instrument in writing or other matter or thing is or may be required in evidence, upon any trial, hearing, inquiry, investigation or other proceeding, authorized by law, wilfully destroys the document with intent thereby to prevent the same from being produced, is guilty of a misdemeanor.

The following section of the penal law dealing with the subject of fraud should be of interest to the accountant:

"A person who, with intent to defraud or conceal any larceny or misappropriation by any person of any money or property:

1. Alters, erases, obliterates, or destroys an account, book of accounts . . . belonging to, or appertaining to the business of a corporation, association, public office or officer, partnership, or individual; or
2. Makes a false entry in any such book of accounts; or
3. Wilfully omits to make true entry of any material particular in any such account or books of account, made, written, or kept by him or under his direction

is guilty of forgery in the third degree." (Sect. 889 Penal Law, N. Y.)

"the object in view of this statute . . . was to protect the corporation, association, partnership or individual who owned the books from being defrauded by means of false entries or alterations therein. The statute was intended to be a *protection against domestic or internal attack, against treachery and betrayal from within.*" *People* v. *Brown*, 140 App. Div. 591. (Italics mine.)

It is also the law that if with the intent to defraud the creditors and to conceal from them and from other persons interested matters materially affecting the financial condition of the firm an employee feloniously, alters, erases and obliterates an entry in the books, whether at the direction of the employer or with his consent is guilty of a crime. See *People* v. *Fish*, 177 App. Div. 152, 154; see also Bishop on *Criminal Law*, Vol. 1 Sect. 355.

Should the accountant, however, conspire with the client to defraud creditors by giving counsel and advice he would be guilty of a crime. Likewise should the accountant conspire with an employee to falsify the records for personal gain he would be guilty of a violation of Sect. 889, *supra*.

It is not expected, in the eyes of the law, that the accountant detect every criminal act of an employee. It is, however, advisable that the accountant use every precaution to prevent being involved in such criminal proceedings. Where the accountant is

aware that an employee of his client is violating this section, that he is making false entries or erasures, for his (employee's) own gain, he should report the matter to the employer. His failure to disclose this information might involve a prosecution for criminal negligence.

Quite frequently the accountant is confronted by an insolvent debtor seeking discharge from his debts. If the records disclose any violation of the law the accountant should inform his client. The penal law provides:

"A person who being an applicant as an insolvent debtor, for a discharge from his debts, or for exoneration or discharge from imprisonment, or having made a general assignment of his property for the payment of his debts, wilfully:

1. Conceals any part of his estate or effects, of any book, account, or other writing relative thereto; or
2. Omits to disclose, to the court . . . any debt which he has collected since the presentation of his application; or
3. Makes or presents . . . in support . . . of application, . . . schedule, book, account, voucher . . . knowing the same to be false; or
4. Fraudulently makes . . . or alters, obliterates, or destroys an account . . . relating to the condition of his affairs

is guilty of a misdemeanor."

Where the accountant is called upon to prepare a statement to be used in proving a fire loss, it is advisable that he thoroughly verify the former existence of the assets alleged to have been destroyed. The law holds that a person who presents or causes to be presented, a false or fraudulent claim or any proof in support of such claim for the payment of a loss upon a contract of insurance is guilty of the commission of a crime. The law further penalizes any person who prepares, makes or subscribes a false or fraudulent account, certificate, affidavit or proof of loss or other document or writing with intent that it may be presented or used in support of such claim.

This law also applies where a person knowingly makes or causes to be made, either directly or indirectly, or through any agency whatsoever, any false statement in writing, with the intention that such false statement reliance shall be placed upon it. A person making such statement with the foregoing intentions, respecting the financial condition or means of ability to pay, of himself, or any other person, firm or corporation, in whom he is interested, or for whom he is acting, for the purpose of procuring in any form

whatsoever the delivery of personal property, the payment of cash, the making of a loan on credit, the extension of credit, or for similar purposes, is guilty of a crime.

Where the accountant, in the course of his audit, detects misconduct of officers and directors of stock corporations he should use the utmost care to prevent the possible claim of conspiracy and should render his report setting forth such misconduct to the proper body. What constitutes misconduct on the part of a director or officer is defined in the statutes.

A director of a stock corporation, who concurs in any vote or act of the directors of such corporation . . . by which it is intended:

1. To make a dividend, except from the surplus profits arising from the business of the corporation, and in the cases and manner allowed by law; or
2. To divide, withdraw, or in any manner pay to the stockholders, or any of them, any part of the capital stock for no consideration; or
3. To discount or receive any note . . . in payment of an installment of capital stock actually called in, and required to be paid, . . . ; or
4. To receive or discount any note . . . to enable any stockholder to withdraw any part of the money paid in by him on his stock; or
5. To apply any portion of the funds of such corporation, except surplus, directly or indirectly, to the purchase of shares of its own stock; or
6. Issues, participates in issuing, or concurs in a vote to issue any increase of its capital stock beyond the amount of the capital stock thereof, duly authorized by law

is guilty of a misdemeanor.

Any director, officer, agents and employee of a corporation . . . or joint stock corporation who:

1. Knowingly receives or possesses himself of any of its property otherwise than in payment for a just demand, and with intent to defraud, omits to make or to cause . . . to be made a full and true entry, . . . or
2. Makes or concurs in making any false entry, or concurs in omitting to make any material entry in its books, . . . or
3. Knowingly concurs in making or publishing any written report, exhibit or statement of its affairs . . . which is false, or
4. Having the custody or control of its books, wilfully refuses or neglects to make any proper entry in the stock book of such corporation as required by law, or to exhibit or allow

the same to be inspected, and extracts to be taken therefrom by any person entitled by law to inspect the same . . . ; or

5. Refuses or neglects to make any report or statement lawfully required by a public officer,

is guilty of a misdemeanor.

The accountant is in confidential relationship to his client. If the client sees fit to disclose the financial condition of his concern he is always at liberty to do so. If the client, as often happens, desires to dispense with the services of his accountant, for no apparent or justifiable reason, the former relationship of confidence still exists. We must control our emotions to prevent the commission of a crime. As justified as he may think he is, the accountant, if he maliciously publishes by writing, printing or otherwise than by mere speech, any statement which exposes any living person to hatred, contempt, ridicule, or causes, or tends to cause any person to be shunned or avoided, or has a tendency to injure any person, corporation, or association of persons, in his or their business or occupation, is guilty of libel. A letter stating that a business firm is in a bad financial condition and has made statements entirely at variance with the facts, and that several suits have been commenced against it is libelous.